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SUBJECT: TURKEY'S HOLDINGS BRACE FOR A BRAVE NEW WORLD

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¶1. (SBU) Summary: The positive evolution of Turkey's macroeconomic environment over the past four years, together with the prospect of EU accession, has prompted Turkish companies at all levels to redefine their corporate strategies. Whereas previously it was rare for a CEO to look out beyond a one- or two-year time horizon, now companies are increasingly trying to develop long-range strategies. The effort has been particularly marked among the giants of Turkish industry, the large holding companies or conglomerates that have long dominated the industrial and commercial landscape. Increasingly, in contrast to their earlier tendency to diversify into a range of sectors, they are seeking to identify key niches where they can build on their natural competitive advantages, in a development that symbolizes the "normalization" of the Turkish economy.

¶2. (SBU) This cable focuses on Turkey's four largest holdings: Koc Holding, Sabanci Holding (Koc's closest rival), Dogan Holding, and Dogus Holding. Subsequent messages will look at specific sectors, small and medium enterprises, and other economic actors. End Summary.

Holdings in the Turkish Economy

¶3. (SBU) Holdings have defined the Turkish economy since soon after the start of the Republic. Initially encouraged through concessions provided by the Turkish government, they were a vehicle through which the country realized its strategy of rapid industrialization through import substitution. Subsequently benefiting from their size and access to capital, the holdings diversified into a wide range of industries to cushion themselves from the vicissitudes of a Turkish economy that was characterized by rampant inflation and repeated boom and bust cycles. By owning companies in different sectors, a holding could balance out these cycles: if one sector did poorly one year another sector might act as a counterbalance. Analysts have predicted that as the economy becomes less volatile, holdings will no longer need such insulation from economic shocks, and will increasingly specialize in particular sectors of the economy.

¶4. (SBU) The persistence of these highly-diversified conglomerates in Turkey long after this business model was discredited in other industrialized countries is also attributable to foreign direct investors' need for a local partner to navigate the shoals of Turkey's anti-foreigner regulatory and judicial systems. In other words, the big groups added value as "fixers" for foreign multinationals.

¶5. (SBU) The last two years have provided hints that Turkey's newfound macroeconomic stability has permitted the start of a move towards greater specialization by the big Turkish groups. The chief

economist at one local brokerage noted to us that the the "holdings are trying to evolve. Some are adjusting successfully to new economic realities, and others are not." In this analyst's view, to date only the Dogan and Dogus Groups have successfully carried out this specialization, while the bluest of Turkey's Blue Chips- Koc and Sabanci-have had more difficulty, perhaps stemming from their larger size and more complicated organizational structure.

KOC HOLDING

¶6. (SBU) Koc Holding is the flagship of Turkish industry. Established in 1926, it operates in sectors including automobiles (in partnership with Ford), durable goods, food, retailing, energy, financial services, tourism, construction and information technology. Five of Turkey's top ten private industrial companies are Koc companies. Koc enjoyed the largest revenue of any holding in 2005, with $18.2 billion in earnings. With Koc Holding's exports accounting for around 10% of Turkey's overall exports, the group enjoys important political and economic influence in Turkey. In line with the Group's expansion plans, Koc undertook two major acquisitions in 2005: a majority stake in Turkey's fifth largest bank Yapi Kredi, in partnership with their Italian partner Unicredito (Euro 1.16 billion) and a 51% stake in Turkey's largest refinery Tupras ($ 4.14 billion), significantly increasing its involvement in the energy sector. Koc executives describe their strategy as one of positioning themselves in sectors that are close to the consumer, so as to benefit from thir longstanding strength in consumer goods. Anaysts at local brokerages are mixed in their assesment of these efforts: some argue that the holdin remains too large and unwieldy, and believe that while it struck a savvy deal for Yapi Kredi, it overpaid for Tupras and will have difficulty making a profit. That difficulty may be accentuated by the Turkish

lira's depreciation in May 2006, as Koc financed the acquisition largely with foreign-exchange denominated loans. Koc CEO Mustafa Koc told the Ambassador that the recent depreciation of the lira is taking a toll on his group for this reason.

SABANCI HOLDING
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¶6. (SBU) Also dating to the 1920s, Sabanci Holding is the largest holding in Turkey by asset size. With revenues exceeding $10 billion in 2005, Sabanci is especially active in the financial services, with presence as well in the food and retail, cement, auto and tire, and textile and chemicals sectors. This expansion follows a new strategy based on a more decentralized management style. Sabanci is according more autonomy to the heads of its business units, in order to increase efficiency and improve decision-making. In contrast to Koc's aggressive expansion over the past year, Sabanci has adopted a more measured approach, staying on the sidelines for a number of recent privatizations, though it is rumored to be interested in the upcoming sale of regional electricity transmission networks.

DOGAN HOLDING

¶7. (SBU) Dogan Holding, though slightly smaller than Koc and Sabanci, is the most profitable of the largest publicly traded holdings. Revenues increased in 2005 to $ 7.8 billion, producing a net profit of $474 million, a stellar 142% increase over 2004. At the start of 2005, Dogan was engaged in three core lines of business: financial services, media, and oil and gas distribution. It exited the banking sector in 2005, however, and now focuses primarily on media and energy (oil and gas distribution), as well as to a lesser degree on insurance, tourism, industry and commerce. Analysts have applauded Dogan's strategy, noting that it secured a premium for its Disbank franchise, and that with a still embryonic advertising market, the holding's focus on media offers significant upside. Dogan has a dominant position in media, helped both by

restrictions on foreign ownership in the sector and by the competition authority separating print from broadcast media in its analysis.

DOGUS HOLDING

¶8. (SBU) Dogus Holding is the only entirely privately held holding amongst the largest four. It is active in the finance, automotive, construction, tourism, and media sectors. It has exited from a number of consumer areas, selling its Tansas supermarket chain. In 2005, the group also sold a 50% share in Garanti Bank to GE Capital of the U.S., thereby reducing its presence in financial services. As of end 2004 (the last year for which statistics are available), the Group's total assets were $23.9 billion, with total revenues of $5.9 billion and a net profit of $326 million. Local economists note that the Sahenk family has historically chosen excellent executives, who are steering Dogus in a successful direction, even though all the company's ventures have not been successful.

Comment

¶9. (SBU) Our contacts argue that "it still makes sense to continue with a holding model," though it needs to evolve to adapt to new economic realities. That process appears to be beginning, as Turkish holdings identify their core businesses, and divest themselves of non-core assets. They continue to forge strategic partnerships with foreign firms to survive in an ever-more competitive international market and can still take advantage of foreign firms' need for a local partner. Despite Minister Babacan's professed desire for "Greenfield" investors, wholly-owned subsidiaries of multinationals are still rare in Turkey. The large groups' size and access to capital - compared to smaller Turkish companies -- gives them a natural advantage in that process, so that holdings are likely to remain a fixture of the Turkish economy for years to come. End Comment.
JONES